



SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Quarterly Report

July - September 2002



2002-2003



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This is the Securities and Futures Commission's second Quarterly Report for the financial year from 1 April 2002 to 31 March 2003. The report aims to enhance the transparency and accountability of the Commission.

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Operations Highlights

1 July to 30 September 2002

1. The SFC recorded a deficit of \$20 million for the first half of this financial year to the end of September, 66% lower than the projected deficit of \$58 million in the approved budget. Reserves stood at \$604 million on 30 September.
2. The half-year revenue was \$177 million, 6% higher than the estimate. This was mainly because the average daily market turnover at \$7.4 billion was slightly higher than the projected \$7 billion.
3. Unaudited expenditure (including depreciation) for the first half was \$197 million, 12% below estimate and 6.4% lower than the corresponding period of last year. Staff costs were down by 5.8%. The SFC had 402 staff as of 30 September (415 at end March 2002).
4. The SFC has completed the consultation process on the 38 pieces of subsidiary legislation required to underpin the Securities and Futures Ordinance.
5. The SFC took action to protect the interests of clients of two brokers and revoked the licence of an account executive of a third who misappropriated clients' assets.
6. The SFC disciplined 20 intermediaries for misconduct and prosecuted nine entities for breaches of law. Two cases of alleged insider dealing were referred to the Financial Secretary.
7. Two senior Commercial Crime Bureau officers began a three-month secondment to the SFC in a bid to strengthen co-operation.
8. The SFC worked with HKEx on third party clearing, on which HKEx released a consultation paper in July.
9. The SFC has continued to process applications for authorization of hedge funds. To set the most appropriate standards, the SFC consulted the public on the disclosure requirements for hedge funds' periodic reports.
10. The SFC assisted HKEx in introducing Equity Linked Instruments for trading on the Exchange in August.
11. The SFC has for the first time introduced a course on personal financial management for university students.
12. Four more institutions were recognised to provide continuous professional training, while internal training by intermediaries has been made easier with relaxation of SFC requirements.
13. Headed by Chairmen of the SFC and the Italian securities regulator CONSOB, an IOSCO task force has completed the drafting of new international standards on ongoing disclosure. The standards were published by IOSCO in October.
14. The SFC participated in the annual Internet Surf Day organised by IOSCO and identified five websites suspected of offering illegal unregistered dealing or investment services.

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15. The SFC took part in the Financial Sector Assessment Programme jointly carried out by the International Monetary Fund and the World Bank.

(Currency is denominated in Hong Kong dollars unless otherwise stated.)



Review of Operations

1 July to 30 September 2002

This is the Securities and Futures Commission's second *Quarterly Report* for the financial year starting 1 April 2002.

On 25 July, Hong Kong Exchanges and Clearing Limited (HKEx) issued a consultation paper on the proposed amendments to Listing Rules relating to initial listing and continuing listing criteria and cancellation of listing procedures. Prices of many low-priced stocks fell significantly on the following day, although the Hang Seng Index only dropped by 1.1%. On 28 July, HKEx withdrew certain sections of the consultation paper in respect of the delisting criteria.

Responding to public opinion, the Financial Secretary appointed an independent Panel of Inquiry to look into the circumstances relating to the preparation and release of the consultation paper. The SFC co-operated fully with the Panel during the inquiry. On 10 September, the Financial Secretary released the report of the Panel of Inquiry.

The Report of the Panel of Inquiry on the Penny Stocks Incident made various recommendations on the consultation process. The SFC fully supports the findings of the report and its recommendations. We have already taken steps in the following areas: agreement with HKEx to consult the SFC's Advisory Committee and Shareholders Group on HKEx's proposal submitted to us for comments; review of the Memorandum of Understanding signed with HKEx to clarify our roles; and the formation of a high-level liaison body for periodic review of systemic and regulatory policy issues.

The Financial Secretary announced in September the appointment of a three-man Expert Group to review the operation of the three-tier regulatory structure, particularly in relation to listing related matters.

During the quarter, global equity markets tumbled on tension in the Middle East and disappointing corporate earnings outlook. Major indices recorded their worst quarter in five years. US benchmark indices fell close to 20% with Asian markets following suit. The Hang Seng Index dropped from the quarter's high of 10,843 points on 9 July to end the quarter at its lowest point of 9,072 points. The quarter's close was 14% lower than the previous quarter's 10,599 close.

Financial Highlights

The SFC recorded a deficit of \$13 million in the second quarter. The accumulated deficit for the six months amounted to \$20 million, 66% lower than the projected deficit of \$58 million in the approved budget. At the end of September, the reserves stood at \$604 million, equivalent to 1.34 times the approved annual operating expenditure estimate of \$450 million.

Average daily stock market turnover (including new issue transactions) for the quarter dropped by 20% to \$6.6 billion from \$8.2 billion in the previous quarter. The daily turnover for the first half averaged \$7.4 billion, slightly higher than the projected \$7 billion in the approved budget. As a result, the half-year levy income, the



major source of revenue, was 7% higher than the estimate in the approved budget. Total revenue in the first half was \$177 million, about 6% higher than the estimated revenue of \$167 million in the approved budget. This was, however, 8% lower than that of the same period last year mainly because of the shrinkage of daily turnover from \$8.5 billion last year.

Our cost control measures kept expenditure well within the approved budget. In the first six months, the SFC recorded a total expenditure (including depreciation) of \$197 million. This was 12% lower than the approved estimate of \$225 million and was down by 6.4% compared with the same period of last year. Staff costs were down by 5.8% mainly due to a decrease in staff number and cash compensation for overtime work, and downward adjustment of salaries to reflect the current market trend when filling vacancies. The total number of staff at the end of September was 402, comprising 347 regular staff and 55 temporary staff (415 at end March 2002, comprising 355 regular and 60 temporary staff).

In September 2002, the SFC incorporated the Investor Compensation Company Ltd with an authorized capital of \$1,000, which was divided into 10,000 shares of \$0.1 each. The company will manage investor compensation funds and perform other functions as enshrined in Part III and Part XII of the Securities and Futures Ordinance. The SFC's investment of two shares of \$0.1 each in the company has been accounted for in this quarter's financial statement. The company has not commenced operations and therefore had no income or expenditure. The investment does not show up in the balance sheet, which is expressed in thousand dollars, but is disclosed in the notes.


The Securities and Futures Ordinance

In the last quarter, the SFC issued consultation conclusions on 18 of the 38 pieces of subsidiary legislation required to underpin the Securities and Futures Ordinance, including five on which consultation papers were issued in the same period. In October, the SFC issued consultation conclusions on the draft Securities and Futures (Financial Resources) Rules, thereby completing the consultation process on all the required subsidiary legislation.

Consultation Conclusions Issued between 1 July and 30 September 2002

1. S&F* (Price Stabilizing) Rules
2. S&F (Leveraged Foreign Exchange Trading - Exemption) Rules
3. S&F (Accounts and Audit) Rules
4. S&F (Client Money) Rules
5. S&F (Client Securities) Rules
6. S&F (Keeping of Records) Rules
7. S&F (Disclosure of Interests - Exclusions) Regulation
8. S&F (Disclosure of Interests - Securities Borrowing and Lending) Rules
9. S&F (Short Selling Exemption and Stock Lending) Rules
10. S&F (Stock Market Listing) Rules, and
11. S&F (Transfer of Functions - Stock Exchange Company) Order
12. Proposed Licensing Fees Under the S&F (Fees) Rules
13. S&F Ordinance (Amendment of Schedule 8) Order

Consultation paper was issued on 5 Aug with consultation closing on 19 Aug

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14. S&F (Miscellaneous) Rules
Consultation paper was issued on 2 Jul with consultation closing on 26 Jul
 15. S&F (Intermediary Information) Rules
Consultation paper was issued on 19 Jul with consultation closing on 8 Aug
 16. S&F (Offences and Penalties) Regulations
Consultation paper was issued on 26 Jul with consultation closing on 16 Aug
 17. S&F (Insurance) Rules
 18. S&F (Fees) Rules
Consultation paper was issued on 30 Jul with consultation closing on 24 Aug
 19. S&F (Financial Resources) Rules
Consultation conclusions were issued on 11 Oct

* S&F stands for Securities and Futures

A subcommittee of the Legislative Council House Committee chaired by The Hon Sin Chung-kai considered 11 items of the draft subsidiary legislation in July. The subcommittee met to consider another batch of 11 items in September. The subsidiary legislation will be published in the Government Gazette later this year.

During the quarter, we issued consultation conclusions on the proposed dual filing requirements. The market was supportive of the proposals to make the SFC the statutory regulator of corporate disclosure.

Preparation for the implementation of the Ordinance continued. The SFC conducted 11 seminars on the various parts of the Ordinance including the new licensing regime for more than 5,480 market participants. Commission staff also spoke at seminars organised by the Hong Kong Securities Institute.

To better plan our licensing resources, we have surveyed exempt dealers and exempt investment advisers, those not being authorized institutions, on the type and number of regulated activities they intend to carry out when the Ordinance comes into effect. The findings, released in August, showed that the majority of intermediaries surveyed would apply for licences.

Upholding the Standard of Intermediaries

The number of registrants and exempt persons fell 3% during the quarter and 9% compared with last year.

Number of SFC Registrants under Various Ordinances and Exempt Persons			
	30 Sep 2002	30 Jun 2002	30 Sep 2001
Securities Ordinance (excluding Securities Margin Financiers)	21,506	22,189	23,712
Securities Ordinance (as Securities Margin Financiers)	214	218	239
Commodities Trading Ordinance	4,592	4,648	4,981
Leveraged Foreign Exchange Trading Ordinance	974	947	920
Exempt Persons	174	177	197
Total	27,460	28,179	30,049

Due to sluggish market conditions and keen competition, broker consolidation continued in the quarter. The SFC provided guidance to brokers, which decided to terminate businesses, with a view to ensuring that clients' assets would be returned in an orderly manner.



The SFC's risk-based monitoring system in May picked up a problem intermediary, Lawsons Securities Company. On 7 June, we issued a restriction notice on Lawsons and its owner to preserve Lawsons' assets and to protect the interests of its clients. On 18 July, the High Court issued an injunction on the owner, thus restricting him from contravening the June notice. On the same day, we obtained on an expedited basis from the High Court an order appointing two administrators to manage his assets.

In early July, the SFC detected that Prosperous Securities Limited had operated with insufficient liquid capital. On 5 July, the firm voluntarily suspended its trading on HKEx. Under SFC's close monitoring, Prosperous made arrangements for the orderly return of stocks and money to clients.

In October, the SFC promptly revoked the registration of an account executive of a broker which earlier reported to the SFC fraudulent acts by the account executive.

Statistical Information and Financial Position of the Securities Market (note 1)		
	As at 30 June 2002	As at 30 June 2001
Total number of securities intermediaries (note 2)	715	729
Total number of active cash clients	571,534	662,027
Total number of active margin clients	57,358	65,374
Balance Sheet	(\$ Million)	(\$ Million)
Cash in hand and at bank (note 3)	59,660	56,715
Amounts receivable from margin clients (note 4)	13,658	13,999
Amounts receivable from clients and other dealers arising from dealing in securities	40,617	41,536
Other assets	30,212	28,841
Total assets	144,147	141,091
Amounts payable to clients and other dealers arising from dealing in securities	65,332	60,540
Total borrowings from financial institutions	6,472	6,297
Other liabilities	21,706	23,187
Total shareholders' fund	50,637	51,067
Total liabilities and shareholders' fund	144,147	141,091

Note 1: The data were extracted from the monthly FRR returns submitted by securities dealers and securities margin financiers.

Note 2: Including registered dealers and registered margin financiers.

Note 3: Cash in hand and at bank includes trust monies held on behalf of clients.

Note 4: Average collateral coverage (the number of times the aggregate market value of securities collateral deposited by clients covers the amounts receivable from margin clients on a given date on an industry-wide basis):

As at 30 June 2002

As at 30 June 2001

3.63

3.85

To facilitate entry to the industry, the SFC has added the Chartered Financial Analyst designation, the Vocational Training Council's Leveraged Foreign Exchange Examination and Hong Kong Securities Institute's New Licensing Examination to the list of recognised industry qualifications. The SFC also approved four more recognised institutions that can provide Continuous Professional Training, bringing the total number to 12.



We have also removed the requirement for corporate licensees to submit advance notification and training materials of their internal training programmes. This relaxation aimed to reduce the administrative burden on the industry.

Facilitating Market Development

The SFC has worked closely with HKEx on its proposal for third party clearing. HKEx issued a consultation paper in July and is analyzing comments received.

As a follow-up to the 28 May disruption of the Automated Trading System (HKATS), the SFC requested HKEx to review its contingency procedures and to consult the market. HKEx in July published a revised contingency plan for extending trading hours in the event of an HKATS disruption.

On product development, the SFC is reviewing applications for authorization by hedge funds. Hedge funds are expected to be available to the public in Hong Kong soon.

To enhance the transparency of hedge funds, we released on 5 September the Hedge Fund Reporting Guidelines for public comment. The guidelines seek to set disclosure standards for annual, semi-annual and quarterly reports. Submissions are being considered.

During the quarter, the SFC authorized 59 new unit trusts/mutual funds, a majority being products with guaranteed features, and 14 other investment products. We also authorized two new fund management companies to manage SFC authorized funds.

Number of Authorized Collective Investment Schemes			
	30 Sep 2002	30 Jun 2002	30 Sep 2001
Unit Trusts and Mutual Funds	1,823	1,899	1,870
Investment-Linked Assurance Schemes	112	109	93
Pooled Retirement Funds	39	39	40
MPF Master Trust / Industry Schemes	49	49	49
MPF Pooled Investment Funds	220	220	214
Other Schemes	35	24	21
Total	2,278	2,340	2,287

In August, HKEx introduced Equity Linked Instruments (ELIs) for trading on the Exchange. The SFC assisted HKEx in reviewing listing documents from issuers and participated in the market test for liquidity providers. As at 30 September, a total of 13 ELIs were listed on HKEx.

Enforcement

The SFC has continued to step up enforcement against corporate misgovernance and market misconduct. In various speeches and media presentations, the SFC reaffirmed its determination to investigate and take action against those who break the securities laws. We will increase 15 posts to boost back-end enforcement and corporate finance resources needed for the implementation of the dual filing requirements.



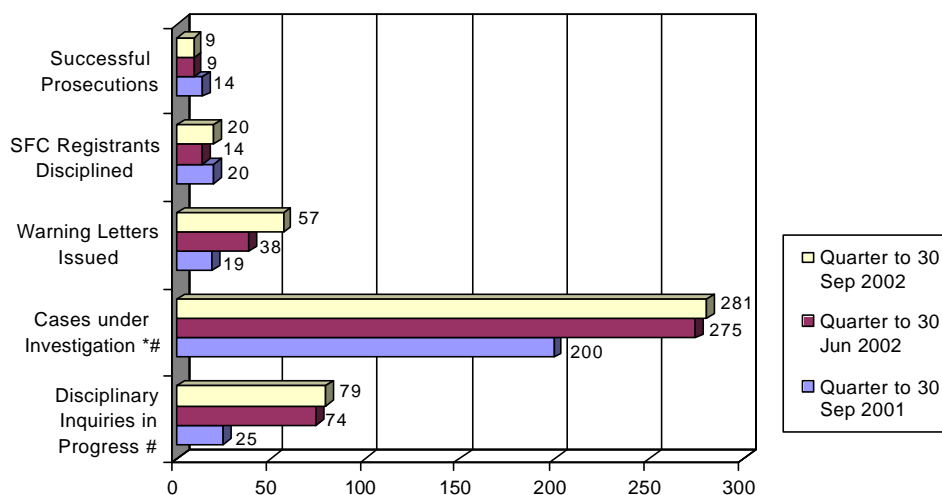
In September, the Commercial Crime Bureau of the Hong Kong Police Force seconded two senior officers to the SFC for three months, further strengthening the exchange of experience and expertise between the two agencies.

During the quarter, the SFC successfully prosecuted nine entities. Five were prosecuted for failing to comply with the Securities (Disclosure of Interests) Ordinance, and the remainders for breaches of the Protection of Investors Ordinance.

Disciplinary action was taken against 20 intermediaries for misconduct. There were two revocations and seven suspensions of registration, four public reprimands and seven private reprimands. There are 79 disciplinary inquiries in progress.

We referred two suspected cases of insider dealing to the Financial Secretary for consideration of appointment of an Insider Dealing Tribunal.

Statistics on Enforcement Actions



* Some cases are ongoing investigations from the previous quarters.

Number of cases as at end of quarters

Strengthening Communication with Investors and Other Stakeholders

The SFC has for the first time partnered with the University of Hong Kong to launch a General Education course on personal financial management for university students. The course, which started on 26 September, features prominent market commentators, industry experts and SFC representatives as speakers.

To promote the public's understanding of hedge funds, the SFC published a new investor leaflet, *How Much Do You Know About Hedge Funds?*, for distribution at the SFC's office and the 12 Consumer Advice Centres of the Consumer Council. Articles explaining the risks of hedge funds were published on the SFC-operated electronic Investor Resources Centre (eIRC).



The investor leaflet *Invest Wisely* was updated to acknowledge the diversity of ELIs following their listing on HKEx.

In this quarter, the SFC received 1,110 investor enquiries and 282 public complaints against registrants, listed companies and market misconduct. These compared with 1,229 enquiries and 195 complaints in the previous quarter, and 742 and 203 cases a year ago.

The SFC published the summer issue of the research based and analytical *Quarterly Bulletin* and continued to publish the monthly newsletter for intermediaries and investors, *SFC Alert*.

We ran three seminars for different stakeholder groups: on the role of SFC, on Investment Linked Assurance Scheme, and on property investment arrangements.

International Co-operation and External Relations

The International Organization of Securities Commissions (IOSCO) has set up a task force responsible for developing a set of international standards on ongoing disclosure. I co-chaired the task force with the Chairman of the Italian securities regulator CONSOB. The standards were adopted by the Technical Committee in October and published by IOSCO at its website www.iosco.org.


The SFC participated in the annual Internet Surf Day organised by the Asia-Pacific Regional Committee of IOSCO. On 30 September, the SFC surfed the Internet for possible fraudulent or abusive activities and identified five websites suspected of offering unregistered dealing or investment services to investors in Hong Kong.

In the area of enforcement co-operation, the SFC received from overseas regulators nine requests: two requesting assistance and seven seeking non-public information. The SFC made four requests for investigatory assistance to overseas regulators.

Together with the Government and other regulators in Hong Kong, the SFC participated in the Financial Sector Assessment Programme conducted by the International Monetary Fund and the World Bank. An important aspect of the process is an assessment of a jurisdiction's observance and implementation of relevant international financial sector standards and codes, such as IOSCO's Objectives and Principles of Securities Regulation in respect of the regulation of Hong Kong's securities and futures markets.

Looking Ahead

Despite the penny stocks incident, there is market consensus that reform must continue. The SFC has always believed that investors and market participants play a key role in the development of Hong Kong's securities and futures markets. The penny stocks incident has reinforced our belief in the importance of working with our stakeholders in introducing the most appropriate policies.



The SFC will continue to solicit and collect market views through different channels. Working with the Government and HKEx, the SFC will press ahead with reforms necessary to enhance the quality and competitiveness of our markets.

The Expert Panel recently appointed by the Financial Secretary will review the lines of communication and delineation of roles and functions under the three-tier regulatory structure, particularly in relation to the regulation of listing matters. The SFC welcomes the appointment of the Expert Panel and looks forward to working with it on this review.

Market conditions remain challenging. The budgeted deficit in the third quarter to 31 December 2002 is \$29 million. Barring significant deterioration in market conditions, there is no reason to believe that the budget deficit for the third quarter will be exceeded.

Andrew Sheng
Chairman

14 November 2002



Independent Review Report To The Securities and Futures Commission (SFC)

(Established in Hong Kong under the Securities and Futures Commission Ordinance)

Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2002 set out on pages 12 to 16.

Directors' responsibilities

The directors are responsible for preparing an interim financial report of the SFC to match the requirements in the relevant provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of, and has been approved by, the directors.

Review work performed

We conducted our review, in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2002.

KPMG
Certified Public Accountants
Hong Kong

11 November 2002



Securities and Futures Commission

Income and Expenditure Account

For the six months ended 30 September 2002

(Expressed in Hong Kong Dollars)

	Note	Unaudited Three Months Ended		Unaudited Six Months Ended	
		30 Sep 2002	30 Sep 2001	30 Sep 2002	30 Sep 2001
		\$'000	\$'000	\$'000	\$'000
Income					
Levies		46,732	45,841	100,793	108,433
Fees and charges		30,350	26,172	58,051	59,169
Investment income		8,510	11,248	17,115	23,853
Other income		239	124	827	656
		<u>85,831</u>	<u>83,385</u>	<u>176,786</u>	<u>192,111</u>
Expenses					
Staff costs		75,785	80,776	152,358	161,676
Premises					
- rent		5,002	5,002	10,005	10,005
- other		2,825	2,797	5,651	5,617
Other expenses		9,315	9,060	17,669	21,938
		<u>92,927</u>	<u>97,635</u>	<u>185,683</u>	<u>199,236</u>
Depreciation		5,752	5,985	10,937	10,912
		<u>98,679</u>	<u>103,620</u>	<u>196,620</u>	<u>210,148</u>
Deficit	2	<u>(12,848)</u>	<u>(20,235)</u>	<u>(19,834)</u>	<u>(18,037)</u>

We have not prepared a separate statement of recognised gains and losses as the deficit would be the only component of such a statement.

The notes on pages 15 and 16 form part of the condensed financial statements.



Securities and Futures Commission

Balance Sheet

At 30 September 2002

(Expressed in Hong Kong Dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 Sep 2002</u> \$'000	<u>Audited</u> <u>At 31 Mar 2002</u> \$'000
Non-current assets			
Fixed assets		35,998	39,868
Held-to-maturity debt securities	3	330,742	298,110
Current assets			
Held-to-maturity debt securities	3	201,479	319,113
Bank deposits		67,450	38,815
Debtors, deposits and prepayments		27,936	24,049
Cash at bank and in hand		964	1,076
		<u>297,829</u>	<u>383,053</u>
		-----	-----
Current liabilities			
Provision for contribution to the Unified Exchange Compensation Fund		-	30,000
Fees received in advance		33,398	33,301
Creditors and accrued charges		27,012	33,737
		<u>60,410</u>	<u>97,038</u>
		-----	-----
Net current assets		<u>237,419</u>	<u>286,015</u>
		-----	-----
Net assets		<u>604,159</u>	<u>623,993</u>
Funding and reserves			
Initial funding by Government		42,840	42,840
Accumulated surplus	2	561,319	581,153
		<u>604,159</u>	<u>623,993</u>

The notes on pages 15 and 16 form part of the condensed financial statements.

Securities and Futures Commission

Cash Flow Statement

For the six months ended 30 September 2002

(Expressed in Hong Kong dollars)

	Unaudited Six months ended 30 Sep 2002 \$'000	Unaudited Six months ended 30 Sep 2001 \$'000
Net cash outflow from operating activities	(34,112)	(35,075)
Returns on investments - interest received	16,091	22,504
Payment to the Unified Exchange Compensation Fund	(30,000)	(36,174)
Investing activities		
Held-to-maturity debt securities bought	(33,524)	-
Held-to-maturity debt securities redeemed	118,200	212,000
Fixed assets bought	(8,132)	(11,272)
Fixed assets sold	-	93
Net cash inflow from investing activities	76,544	200,821
Increase in cash and cash equivalents	28,523	152,076
Cash and cash equivalents at beginning of the six months	39,891	107,093
Cash and cash equivalents at end of the six months	68,414	259,169
Reconciliation of deficit of income over expenses to net cash outflow from operating activities :		
Deficit	(19,834)	(18,037)
Investment income	(17,115)	(23,853)
Depreciation	10,937	10,912
Loss/(profit) on sale of fixed assets	1	(43)
(Increase)/decrease in debtors, deposits and prepayments	(2,537)	4,528
Decrease in creditors and accrued charges	(5,661)	(8,992)
Increase in fees received in advance	97	410
Net cash outflow from operating activities	(34,112)	(35,075)
Analysis of the balance of cash and cash equivalents :		
	Unaudited At 30 Sep 2002 \$'000	Unaudited At 30 Sep 2001 \$'000
Bank deposits	67,450	257,074
Cash at bank and in hand	964	2,095
	68,414	259,169



Securities and Futures Commission

Notes to the Condensed Financial Statements
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)

1. Basis of preparation

We have prepared the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the SFC's statutory financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2002 to the interim financial report.

There were no significant changes in the operation of the SFC for the six months ended 30 September 2002.

2. Accumulated surplus

Movements of accumulated surplus during the six months ended 30 September 2002 are as follows :

	<u>Unaudited</u>
	\$'000
Balance at 31 March 2002	581,153
Deficit for the period	(19,834)
	<hr/>
Balance at 30 September 2002	<u>561,319</u>

3. Held-to-maturity debt securities

As of 30 September 2002, the total market value of held-to-maturity debt securities amounted to \$558,481,000 (31 March 2002: \$632,989,000), which was above the total carrying cost of \$532,221,000 (31 March 2002: \$617,223,000).



Securities and Futures Commission

Notes to the Condensed Financial Statements
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)

4. Ageing analysis of debtors and creditors

There was no material debtor balance and creditor balance included in “debtors, deposits and prepayments” and “creditors and accrued charges” respectively as at 30 September 2002. Therefore we do not provide ageing analysis on debtors and creditors.

5. Exchange fluctuation

All our balance sheet items are denominated in either United States dollars or Hong Kong dollars, and, as a result, we are not exposed to significant exchange rate risk.

6. Investments in subsidiaries

We recognised our investment in FinNet Limited (FinNet) and Investor Compensation Company Limited (ICC) since 31 March 2002.

The SFC formed FinNet on 6 November 2000 with an authorised share capital of \$10,000 and issued share capital of \$2 and ICC on 11 September 2002 with an authorised share capital of \$1,000 and issued share capital of \$0.2.

The objective of FinNet is to operate an electronic network to facilitate payment and delivery transactions and interconnection of all financial institutions and financial entities in Hong Kong.

The objective of ICC is to perform functions relating to the compensation of investors and other functions under Parts III and XII of the Securities and Futures Ordinance.

Both companies are wholly owned subsidiary of the SFC. However, they were not shown in the balance sheet which was expressed in thousand dollars.

Both companies have not commenced operation. The balance sheets of the companies as at 30 September 2002 and the income and expenditure accounts for the six months then ended were immaterial. Therefore, we have not prepared consolidated financial statements.



Unified Exchange Compensation Fund (the Fund)

Report of the Securities Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the six months ended 30 September 2002.

1. ESTABLISHMENT OF THE FUND

Part X of the Securities Ordinance (Chapter 333) established the Fund.

2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 19 to 25.

3. MEMBERS OF THE COMMITTEE

The members of the Committee during the six months and up to the date of this report were: -

Mr. Mark Dickens, JP
Mrs. Alexa Lam
Mr. David M. Roberts
Mr. Kwong Ki Chi, GBS
Mr. T. Brian Stevenson, SBS

4. INTERESTS IN CONTRACTS

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the six months ended 30 September 2002.

On behalf of the Committee

Mark Dickens
Chairman

28 October 2002



Independent review report to the board of directors of Securities and Futures Commission (the SFC)

(Established in Hong Kong under the Securities and Futures Commission Ordinance)

Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2002 of the Unified Exchange Compensation Fund (the Fund) established under Section 99 of the Hong Kong Securities Ordinance set out on pages 19 to 25.

Directors' responsibilities

The SFC is responsible for preparing an interim report of the Fund to match the requirements in the relevant provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of the SFC and has been approved by the Securities Compensation Fund Committee.

Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2002.

KPMG
Certified Public Accountants
Hong Kong

28 October 2002



Unified Exchange Compensation Fund

Income and Expenditure Account

For the six months ended 30 September 2002

(Expressed in Hong Kong dollars)

	Unaudited Three Months Ended		Unaudited Six Months Ended	
	<u>30 Sep 2002</u>	<u>30 Sep 2001</u>	<u>30 Sep 2002</u>	<u>30 Sep 2001</u>
	\$'000	\$'000	\$'000	\$'000
Income				
Investment Income	11,363	9,940	22,717	19,973
Unrealised gain on revaluation of debt securities	4,735	-	9,408	-
	<u>16,098</u>	<u>9,940</u>	<u>32,125</u>	<u>19,973</u>
	-----	-----	-----	-----
Expenses				
Loss on redemption of debt securities	2,965	-	2,965	-
Auditors' remuneration	10	10	21	21
Bank charges	82	39	151	75
Exchange difference	11	-	11	-
Professional fees	56	57	103	128
Sundry expenses	-	-	1	1
	<u>3,124</u>	<u>106</u>	<u>3,252</u>	<u>225</u>
	-----	-----	-----	-----
Surplus	12,974	9,834	28,873	19,748
Accumulated surplus brought forward	253,677	201,448	237,778	191,534
	<u>-----</u>	<u>-----</u>	<u>-----</u>	<u>-----</u>
Accumulated surplus carried forward	266,651	211,282	266,651	211,282
	<u>=====</u>	<u>=====</u>	<u>=====</u>	<u>=====</u>

The notes on pages 23 to 25 form part of the condensed financial statements.

Unified Exchange Compensation Fund

Balance Sheet

At 30 September 2002

(Expressed in Hong Kong dollars)

	Note	Unaudited At 30 Sep 2002 \$'000	Audited At 31 Mar 2002 \$'000
Current assets			
Debt securities		709,526	728,519
Contributions receivable		-	30,000
Interest receivable		5,401	8,383
Levy receivable		4,521	6,248
Bank fixed and call deposits		161,406	49,723
Cash at bank		40	211
		880,894	823,084
Current liabilities			
Accounts payable and accrued charges		3,022	2,724
Provision for compensation	3	60,829	40,613
		63,851	43,337
Net current assets			
		817,043	779,747
Net assets			
		817,043	779,747
Representing:			
Compensation fund			
Contributions from the SEHK		46,450	46,450
less: Compensation paid	2	(83,855)	(80,743)
Provision for compensation	3	(25,231)	(12,343)
add: Recoveries	4	10,572	11,277
Replenishments from the SEHK		16,360	16,360
		(35,704)	(18,999)
Excess transaction levy from the SEHK		353,787	353,787
Special contribution		3,500	3,500
Additional contributions from the SEHK		300,000	300,000
Additional contributions from the SFC		330,000	330,000
Special levy surplus		3,002	3,002
Transaction Levy	5	78,564	41,181
Accumulated surplus		266,651	237,778
		1,335,504	1,269,248
less: Compensation paid	2	(447,159)	(442,232)
Provision for compensation	3	(35,598)	(28,270)
		852,747	798,746
		817,043	779,747

The notes on pages 23 to 25 form part of the condensed financial statements.



Unified Exchange Compensation Fund

Statement of Recognised Gains and Losses
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited Six Months Ended 30 Sep 2002</u> \$'000	<u>Unaudited Six Months Ended 30 Sep 2001</u> \$'000
Recoveries received	4	593	2,459
Recoveries re-distributed to claimants	4	(1,298)	(519)
(Increase)/decrease in provision for compensation		(20,216)	91,841
Compensation paid out of the Fund	2	(8,039)	(9,485)
Transaction Levy	5	37,383	5,581
Net gains not recognised in the income and expenditure account		<u>8,423</u>	<u>89,877</u>
Surplus		<u>28,873</u>	<u>19,748</u>
Total recognised gains		<u><u>37,296</u></u>	<u><u>109,625</u></u>

The notes on pages 23 to 25 form part of the condensed financial statements.

Unified Exchange Compensation Fund
Cash Flow Statement
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2002 \$'000	Unaudited Six Months Ended 30 Sep 2001 \$'000
Net cash inflow from operating activities	22	1,497
Returns on investments - interest received	25,699	22,571
Investing activities		
Debt securities redeemed	245,000	123,000
Debt securities bought	(219,575)	-
Net cash inflow from investing activities	25,425	123,000
Financing		
Recoveries received	593	2,459
Recoveries re-distributed to claimants	(1,298)	(519)
Transaction levy received	39,110	-
Compensation paid	(8,039)	(9,485)
Additional contributions from the SEHK	-	36,174
Additional contributions from the SFC	30,000	36,173
Net cash inflow from financing	60,366	64,802
Increase in cash and cash equivalents	111,512	211,870
Cash and cash equivalents at beginning of the six months	49,934	132,185
Cash and cash equivalents at end of the six months	161,446	344,055
Reconciliation of surplus for the six months to net cash inflow from operating activities:		
Surplus	28,873	19,748
Investment income	(22,717)	(19,973)
Unrealised gain on revaluation of debt securities	(9,408)	-
Loss on redemption of debt securities	2,965	-
Exchange loss	11	-
Increase in accounts payable and accrued charges	298	1,722
Net cash inflow from operating activities	22	1,497
Analysis of changes in financing:		
	<u>Recoveries</u>	<u>Compensation Paid</u>
Balance at 1 April 2001	9,854	(501,974)
Cash inflow/(outflow) from financing	1,940	(9,485)
Balance at 30 September 2001	11,794	(511,459)
Balance at 1 April 2002	11,277	(522,975)
Cash outflow from financing	(705)	(8,039)
Balance at 30 September 2002	10,572	(531,014)
Analysis of the balance of cash and cash equivalents:		
	<u>Unaudited At 30 Sep 2002 \$'000</u>	<u>Unaudited At 30 Sep 2001 \$'000</u>
Cash at bank	40	208
Bank fixed and call deposits	161,406	343,847
	161,446	344,055

Unified Exchange Compensation Fund
Notes to the Condensed Financial Statements
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)



1. ACCOUNTING POLICIES

We have prepared the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the Fund's statutory financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2002 to the interim financial report.

2. COMPENSATION PAID

	\$'000
Compensation paid up to the \$8 million limit as set out in Section 109(3) of the Securities Ordinance	
Balance as at 1 April 2001	72,582
Add: compensation paid during the year ended 31 March 2002	<u>8,161</u>
Balance as at 31 March 2002	80,743
Add: compensation paid during the six months ended 30 September 2002	<u>3,112</u>
Balance as at 30 September 2002	<u><u>83,855</u></u>
Compensation paid in excess of the \$8 million limit pursuant to Section 113(5A) of the Securities Ordinance	
Balance as at 1 April 2001	429,393
Add: compensation paid during the year ended 31 March 2002	<u>12,839</u>
Balance as at 31 March 2002	442,232
Add: compensation paid during the six months ended 30 September 2002	<u>4,927</u>
Balance as at 30 September 2002	<u><u>447,159</u></u>
Total compensation paid as at 31 March 2002	<u><u>522,975</u></u>
Total compensation paid as at 30 September 2002	<u><u>531,014</u></u>



Unified Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the six months ended 30 September 2002

(Expressed in Hong Kong dollars)


2. COMPENSATION PAID - Cont'd

In eight defaults since 1998, the SEHK proposed and the SFC approved increases in the \$8 million limit via payment of up to \$150,000 per claimant or if higher the claimant's proportional share of the \$8 million limit. The relevant defaults where we made payments during the six months ended 30 September 2002 were:

Chak Fung Securities Co. Ltd.	\$189,000
Foreground Securities Co. Ltd.	\$4,108,000
Lawsons Securities Company	\$765,000
Win Successful Securities Ltd.	\$2,977,000

3. PROVISION FOR COMPENSATION

	\$'000
Provision for compensation to be paid up to the \$8 million limit	
Balance as at 1 April 2001	10,880
Less: amount paid during the year ended 31 March 2002	(8,161)
unused provision reversed during the year	
ended 31 March 2002	(372)
Add: additional provision made for the year ended 31 March 2002	<u>9,996</u>
Balance as at 31 March 2002	12,343
Add: additional provision made during the six months	
ended 30 September 2002	16,000
Less: amount paid during the six months ended 30 September 2002	<u>(3,112)</u>
Balance as at 30 September 2002	<u><u>25,231</u></u>
Provision for compensation to be paid in excess of the \$8 million limit	
Balance as at 1 April 2001	112,400
Less: amount paid during the year ended 31 March 2002	(12,839)
unused provision reversed during the year ended 31 March 2002	(84,701)
Add: additional provision made during the year ended 31 March 2002	<u>13,410</u>
Balance as at 31 March 2002	28,270
Less: amount paid during the six months ended 30 September 2002	(4,927)
unused provision reversed during the six months	
ended 30 September 2002	(428)
Add: additional provision made during the six months	
ended 30 September 2002	<u>12,683</u>
Balance as at 30 September 2002	<u><u>35,598</u></u>



Unified Exchange Compensation Fund
Notes to the Condensed Financial Statements
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)

3. PROVISION FOR COMPENSATION - Cont'd

We made provision for unprocessed claims in respect of seven SEHK exchange participants for which the SEHK has published a notice calling for claims pursuant to Section 112 of the Securities Ordinance. The maximum liabilities of the Fund in respect of six of these default cases can exceed the normal \$8 million limit. In respect of two of these default cases, we revised the provision according to claims being processed.

4. RECOVERIES

In exercising its subrogated rights, the SFC recovered \$593,000 for the Fund in the six months ended 30 September 2002 (six months ended 30 September 2001: \$2,459,000). During the six months, the Fund re-distributed recoveries of \$1,298,000 to claimants (six months ended 30 September 2001: \$519,000).

5. TRANSACTION LEVY

With effect from 1 September 2001, the Fund would receive transaction levy at 0.002% chargeable for every leviable transaction in the SEHK. During the six months ended 30 September 2002, the Fund recognised \$37,383,000 transaction levy (six months ended 30 September 2001: \$5,581,000).

6. CONTINGENT LIABILITIES

As at the date of this report, the SEHK has received claims against eight exchange participants. They are subject to the normal \$8 million ceiling pursuant to Section 109 of the Securities Ordinance. The validity of these claims is under investigation. We have not made any provision for these claims. The maximum contingent liability of the Fund to these claims is \$64 million (As at 31 March 2002: \$56 million).



Commodity Exchange Compensation Fund (the Fund)

Report of the Futures Compensation Fund Committee (the Committee)

The members of the Committee present their quarterly report and the unaudited condensed financial statements for the six months ended 30 September 2002.

1. ESTABLISHMENT OF THE FUND

Part VIII of the Commodities Trading Ordinance (Chapter 250) established the Fund.

2. FINANCIAL RESULTS

The Committee presents the financial results which are set out in the condensed financial statements on pages 28 to 32.

3. MEMBERS OF THE COMMITTEE

The members of the Committee during the six months and up to the date of this report were:-

Mr. Mark Dickens, JP
Mrs. Alexa Lam
Mr. William D. Grossman
Mr. Mark Ho
Mr. T. Brian Stevenson, SBS

4. INTERESTS IN CONTRACTS

No contract of significance to which the Fund was a party and in which a Committee Member had a material interest, whether directly or indirectly, subsisted at the balance sheet date or at any time during the six months ended 30 September 2002.

On behalf of the Committee

Mark Dickens
Chairman

28 October 2002



Independent review report to the board of directors of Securities and Futures Commission (SFC)

(Established in Hong Kong under the Securities and Futures Commission Ordinance)

Introduction

We have been instructed by the SFC to review the interim financial report for the six months ended 30 September 2002 of the Commodity Exchange Compensation Fund (the Fund) established under Section 77 of the Hong Kong Commodities Trading Ordinance set out on pages 28 to 32.

Directors' responsibilities

The SFC is responsible for preparing an interim report of the Fund to match the requirements in the relevant provisions of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited and to comply with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board. The interim financial report is the responsibility of SFC, and has been approved by the Futures Compensation Fund Committee.

Review work performed

We conducted our review in accordance with Statement of Auditing Standards 700 "Engagements to review interim financial reports" issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

Review conclusion

On the basis of our review, which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 September 2002.

KPMG
Certified Public Accountants
Hong Kong

28 October 2002

Commodity Exchange Compensation Fund

Income and Expenditure Account

For the six months ended 30 September 2002

(Expressed in Hong Kong dollars)

	Unaudited		Unaudited	
	Three Months Ended		Six Months Ended	
	<u>30 Sep 2002</u>	<u>30 Sep 2001</u>	<u>30 Sep 2002</u>	<u>30 Sep 2001</u>
	\$'000	\$'000	\$'000	\$'000
Income				
Investment Income	1,759	1,550	3,521	3,227
Unrealised gain on revaluation of debt securities	335	-	1,125	-
	<u>2,094</u>	<u>1,550</u>	<u>4,646</u>	<u>3,227</u>
	-----	-----	-----	-----
Expenses				
Loss on redemption of debt securities	258	-	258	-
Auditors' remuneration	11	10	21	21
Bank charges	20	14	34	26
Professional fees	14	14	18	28
Sundry expenses	-	-	1	1
	<u>303</u>	<u>38</u>	<u>332</u>	<u>76</u>
	-----	-----	-----	-----
Surplus	1,791	1,512	4,314	3,151
Accumulated surplus brought forward	45,164	37,235	42,641	35,596
	<u>46,955</u>	<u>38,747</u>	<u>46,955</u>	<u>38,747</u>
	=====	=====	=====	=====

The notes on page 32 form part of the condensed financial statements.



Commodity Exchange Compensation Fund

Balance Sheet

At 30 September 2002

(Expressed in Hong Kong dollars)

	<u>Note</u>	<u>Unaudited</u> <u>At 30 Sep 2002</u> \$'000	<u>Audited</u> <u>At 31 Mar 2002</u> \$'000
Current assets			
Debt securities		108,758	111,159
Interest receivable		889	1,154
Levy receivable		575	481
Bank fixed and call deposits		13,764	3,677
Cash at bank		12	60
		<hr/>	<hr/>
		123,998	116,531
Current liabilities			
Accounts payable and accrued charges		235	253
		<hr/>	<hr/>
Net current assets		123,763	116,278
		<hr/> <hr/>	<hr/> <hr/>
Net assets		123,763	116,278
		<hr/> <hr/>	<hr/> <hr/>
Representing:			
<u>Compensation fund</u>			
Contributions from HKFE	2	21,500	21,600
Contract levy	3	66,914	63,643
Accumulated surplus		46,955	42,641
		<hr/>	<hr/>
		135,369	127,884
Deduct: Compensation paid		(24,457)	(24,457)
Add: Recoveries		12,851	12,851
		<hr/>	<hr/>
		123,763	116,278
		<hr/> <hr/>	<hr/> <hr/>

The notes on page 32 form part of the condensed financial statements.



Commodity Exchange Compensation Fund

Statement of Recognised Gains and Losses
For the six months ended 30 September 2002
(Expressed in Hong Kong dollars)

	<u>Note</u>	Unaudited Six Months Ended <u>30 Sep 2002</u> \$'000	Unaudited Six Months Ended <u>30 Sep 2001</u> \$'000
Net refund of contributions to HKFE		(100)	-
Contract levy	3	3,271	2,961
Net gains not recognised in the income and expenditure account		<u>3,171</u>	<u>2,961</u>
Surplus		<u>4,314</u>	<u>3,152</u>
Total recognised gains		<u><u>7,485</u></u>	<u><u>6,113</u></u>

The notes on page 32 form part of the condensed financial statements.



Commodity Exchange Compensation Fund

Cash Flow Statement

For the six months ended 30 September 2002

(Expressed in Hong Kong dollars)

	Unaudited Six Months Ended 30 Sep 2002 \$'000	Unaudited Six Months Ended 30 Sep 2001 \$'000
Net cash outflow from operating activities	(92)	(97)
Returns on investments - interest received	3,786	3,108
Investing activities		
Debt securities redeemed	20,000	28,500
Debt securities bought	(16,732)	-
Net cash inflow from investing activities	3,268	28,500
Financing		
Net contribution refunded to HKFE	(100)	-
Contract levy received	3,177	2,983
Net cash inflow from financing	3,077	2,983
Increase in cash and cash equivalents	10,039	34,494
Cash and cash equivalents at beginning of the six months	3,737	19,149
Cash and cash equivalents at end of the six months	<u>13,776</u>	<u>53,643</u>
Reconciliation of surplus for the six months to net cash outflow from operating activities:		
Surplus	4,314	3,151
Investment income	(3,521)	(3,227)
Unrealised gain on revaluation of debt securities	(1,125)	-
Loss on redemption of debt securities	258	-
Decrease in accounts payable and accrued charges	(18)	(21)
Net cash outflow from operating activities	<u>(92)</u>	<u>(97)</u>
Analysis of the balance of cash and cash equivalents:		
	Unaudited At 30 Sep 2002 \$'000	Unaudited At 30 Sep 2001 \$'000
Cash at bank	12	12
Bank fixed and call deposits	13,764	53,631
	<u>13,776</u>	<u>53,643</u>

Commodity Exchange Compensation Fund

Notes to the Condensed Financial Statements

For the six months ended 30 September 2002

(Expressed in Hong Kong dollars)



1. ACCOUNTING POLICIES

We have prepared the interim financial report in accordance with the requirements of the Main Board Listing Rules of the Stock Exchange of Hong Kong Limited, including compliance with International Accounting Standard 34 "Interim financial reporting" adopted by the International Accounting Standards Board.

The interim financial report is unaudited and the financial information relating to the financial year ended 31 March 2002 included in this report does not constitute the Fund's statutory financial statements for that financial year but is derived from those financial statements.

We have applied the same accounting policies adopted in the financial statements for the year ended 31 March 2002 to the interim financial report.

2. CONTRIBUTIONS FROM HKFE

	\$'000
Balance as at 1 April 2001	21,300
Add: Contribution received during the year ended 31 March 2002	800
Deduct: Refunds to outgoing shareholders during the year ended 31 March 2002	(500)
	<hr/>
Balance as at 31 March 2002	21,600
Add: Contributions received during the six months ended 30 September 2002	400
Deduct: Refunds to outgoing shareholders during the six months ended 30 September 2002	(500)
	<hr/>
Balance as at 30 September 2002	<u>21,500</u>

3. CONTRACT LEVY

During the six months ended 30 September 2002, the Fund recognised \$3,271,000 contract levy (six months ended 30 September 2001: \$2,961,000).